

Admi Huel
4/20/05
CHS

REBUTTAL TESTIMONY

of

**Dianna Hathhorn
Accountant**

**Accounting Department
Financial Analysis Division
Illinois Commerce Commission**

**Reconciliation of revenues collected under gas adjustment
charges with actual costs prudently incurred**

The Peoples Gas Light and Coke Company

Docket No. 01-0707

OFFICIAL FILE

I.C.C. DOCKET NO. 01-0707
Staff Exhibit No. 13.00
Witness Hathhorn
Date 4/20/05 Rehearal TR

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1 Witness Identification

2 Q. Please state your name and business address.

3 A. My name is Dianna Hathhorn. My business address is 527 East Capitol
4 Avenue, Springfield, Illinois 62701.

5
6 Q. Have you previously filed testimony in this proceeding?

7 A. Yes, my additional direct / rebuttal testimony is ICC Staff Exhibit 9.00.

8
9 Q. What is the purpose of this testimony?

10 A. I am presenting my position based upon The Peoples Gas Light and Coke
11 Company's ("Peoples" or "Peoples Gas" or "Company") additional rebuttal
12 testimony. I also address Ms. Decker's enovate income adjustment.
13 (City-CUB Ex. 1.0)

14
15 Refinery Gas Purchases Adjustment

16 Q. Please summarize the reason for the Refinery Gas Purchases
17 Adjustment.

18 A. As discussed in ICC Staff Exhibit 9.00, pp. 11-14, prior to FY2001,
19 Peoples purchased refinery fuel gas ("RFG") from Citgo at 75% of the
20 average city gate price, pursuant to a contract ("the Agreement") with PDV
21 Midwest Refining LLC ("PDVMR"), formerly known as UNO-VEN
22 Company, and also known as "Citgo". Beginning in FY2001, the

23 Agreement with Peoples Gas ended, and instead PERC, Peoples Gas'
24 affiliate, purchased the RFG from Citgo at the same terms, for later re-
25 sale to Peoples Gas. This resulted in an unnecessary increase in gas
26 cost to PGA ratepayers.

27
28 Q. In response, Mr. Wear states that Peoples' purchased RFG during the
29 reconciliation period from Enron MW, LLC ("EMW"). (Respondent's Ex. L,
30 Additional Rebuttal Testimony of David Wear, p. 46 at lines 1023-1025)
31 Is this correct?

32 A. The diagram of the RFG deal shows that the physical arrangement was
33 for Peoples Gas to buy the RFG from Citgo. (See Attachment B to Staff
34 Ex. 9.00) Its affiliate PERC, as well as EMW were only pass through
35 entities for the RFG. Deals between EMW and PERC were not arms-
36 length, since PEC, Peoples' parent, shared revenues with EMW via oral
37 agreements. (Staff Ex. 9.00, pp. 6-11 generally; see lines 200-204)
38 Peoples witness Morrow confirmed that Peoples, through its affiliates, was
39 a 50/50 partner with EMW in enovate. (Respondent's Ex. N, Additional
40 Rebuttal Testimony of William E. Morrow, p. 3 at lines 47-53)

41
42 Q. How does Peoples Gas attempt to justify why it did not renew the
43 Agreement with Citgo?

44 A. After the Agreement terminated, Mr. Wear claims Peoples had no
45 unilateral option to extend it at the existing price. (Respondent's Ex. L,
46 Additional Rebuttal Testimony of David Wear, p. 46 at lines 1032-1033)
47

48 Q. Did Peoples explain why PERC conducted transactions under the same
49 terms of the Agreement even though the Agreement had ended and was
50 not renewed?

51 A. No, Peoples did not attempt to explain why Citgo maintained the same
52 terms with Peoples' affiliate, PERC, but not with Peoples Gas.
53

54 Q. Peoples states "[a]ny disallowance whatsoever is penalizing Peoples Gas
55 for buying discounted gas for its customers." (Respondent's Ex. L,
56 Additional Rebuttal Testimony of David Wear, p. 47 at lines 1045-1046)
57 Do you have a response to that statement?

58 A. *Such a statement is disingenuous. The disallowance proposed by Staff*
59 *calculates the increased gas costs passed along to ratepayers because*
60 *Peoples Gas' chose to allow PERC to assume the Citgo RFG contract.*
61 *When Peoples transferred the Agreement to PERC, Peoples also paid*
62 *PERC a premium for its RFG purchases. The premium is the difference*
63 *between the purchase price Peoples paid before the transfer of the*
64 *Agreement, which was 75% of the average city gate price, and the*
65 *purchase price Peoples paid after the Agreement was transferred, which*

was 95% of the average city gate price for that same gas. (ICC Staff Exhibit 9.00, pp. 11-14)

PEC Storage Optimization Contract Adjustment

Q. Peoples states, "Respondent and EMW were parties to an agreement whereby the parties would share in the revenue generated from the optimization of unutilized storage capacity." (Respondent's Ex. L, Additional Rebuttal Testimony of David Wear, p. 37 at lines 812-814) Were these the only two parties that received revenue under the Storage Optimization Contract ("SOC")?

A. No. As discussed above and in my direct testimony, Peoples' parent, PEC, had oral revenue sharing agreements with EMW during the reconciliation period. These oral agreements materially affected the amount of SOC revenues credited to the PGA. As a result, the PGA was credited only \$334,344, rather than \$957,334 (Staff Ex. 9.00, Schedule 9.02) due to monies that were paid to PEC via PERC for management fees and revenues generated under the SOC. This fact directly contradicts Peoples witness Zack's statement that "[t]here is no evidence that income earned by Respondent's parent corporation...affects...gas costs." (Respondent's Ex. K, Additional Rebuttal Testimony of Thomas E. Zack, p. 12, lines 246-249)

88 Trunkline Deal Adjustment

89 Q. Peoples Gas' rebuttal testimony concerning the Trunkline deal primarily
90 discusses the pricing structure of the gas purchases between Peoples
91 Gas and EMW. (Respondent's Ex. L, Additional Rebuttal Testimony of
92 David Wear, pp. 42-43) Was this the reason for Staff's adjustment?

93 A. No. Staff's direct testimony outlines how EMW, once again, was used
94 simply as a conduit for purchases between Peoples Gas and enovate.
95 (Staff Ex. 9.00, pp. 17-19) That is to say, there was no change in prices
96 or quantities for the pass-through transactions of EMW to Peoples Gas.
97 (Staff Ex. 7.00, pp. 68-69) Further, the lack of arms-length relationship
98 between EMW and Peoples Gas belies Peoples' position that this was
99 just another supply purchase. Peoples' revenue sharing agreement with
100 EMW allowed PEC to profit from the Trunkline deal, increasing gas costs
101 to PGA ratepayers.

102
103 enovate- PEC and Enron Income Adjustments

104 Q. Peoples Gas states that Staff's recommendations for refunds of enovate
105 profits have no relationship to the subject matter of this proceeding.
106 (Respondent's Ex. K, Additional Rebuttal Testimony of Thomas E. Zack,
107 p. 12, lines 244-246) What is your response to such a claim?

108 A. Mr. Zack is incorrect. The primary purpose of this case is to have the
109 utility demonstrate that its gas supplies bought during the reconciliation

110 year were prudently purchased. (Commencing Order, dated 11/7/2001, at
111 p. 2) This requires analyzing Peoples Gas' purchases of its gas supply.
112 Transactions Peoples Gas had with affiliates call for more scrutiny. As
113 stated in Staff's additional direct testimony, Peoples Gas and enovate
114 were affiliates, and conducted numerous transactions within the
115 reconciliation period. (Staff Ex. 9.00, pp. 4-6) Staff also presents
116 concerns about Peoples' affiliate relationships in Staff Exhibit 9.00. One
117 example is the unexplained contract between Peoples' affiliate PERC
118 and EMW concerning Manlove storage field. (Staff Ex. 9.00, Attachment
119 A-1) Finally, the fact that PEC and Enron/EMW had unwritten
120 agreements to share revenues generated by Manlove storage field
121 through hub transactions must be considered in determining the
122 prudence of Peoples Gas FY2001 purchases. (Staff Ex. 9.00, pp. 6-11
123 and Attachments C and D)

124
125 Q. Please summarize Staff's reason for the enovate Adjustments.

126 A. As discussed in ICC Staff Exhibit 9.00, pp. 20-23 and Dr. Rearden's Ex.
127 7.00, pp. 52-53, if it were not for Peoples Gas' gas distribution system
128 and its position as a utility, enovate could not conduct business. Further,
129 the profit from this arrangement benefited only PEC's shareholders,
130 rather than Peoples Gas' ratepayers through the PGA.

132 Q. Peoples' disagrees with the premise that enovate profits should be
133 refunded through the PGA since every company that Peoples does
134 business with presumably profits through use of its system.
135 (Respondent's Ex. K, Additional Rebuttal Testimony of Thomas E. Zack,
136 p. 13, lines 260-275) Does this position have merit?

137 A. No it does not, since the analogy is to companies in arms-length business
138 relationships. That is not the case in this instance. Peoples' relationship with
139 enovate is not analogous to "another company" (line 274-275), since Mr.
140 Morrow acknowledges the affiliate relationship enovate had with PEC.
141 (Respondent's Ex. N, Additional Rebuttal Testimony of William E. Morrow, p.
142 3, lines 47-56) PEC's own auditors raised concerns about the Peoples-
143 enovate operation. (Staff Ex. 9.00, p. 10, lines 243-262 and Attachment E)
144 Peoples Gas has not provided documentation in order for Staff to determine
145 the extent to which enovate's profits were tied to Peoples' gas purchasing and
146 Hub activity. (Staff Ex. 9.00, pp. 23-27 and Attachment G) It continues to
147 provide unquantified responses, such as "some amount" of enovate's income
148 was the product of speculative trading. (Respondent's Ex. N, Additional
149 Rebuttal Testimony of William E. Morrow, p. 5, lines 101-102) This statement
150 provides Staff with none of the requested clarifying details or documentation
151 (Staff Ex. 9.00, p. 22, lines 520-522) in order to revise its adjustments.
152 Incredibly, Peoples itself contends it does not know the aforementioned

speculative trading income amount, neither would it provide an estimate, as requested:

"PERC does not know the amount of income that was the product of speculative trading." (Response to Staff Data Request POL-22.3)

Staff's direct testimony presents an enovate document (Attachment H) that clearly shows a relationship existed between enovate and Peoples Gas' PGA on several enovate transactions, for example, "ANR Rolling Thunder" and "Tidal Wave". Peoples admits that credits for these and other deals *affected its gas charge*, yet refuses to provide the necessary documentation and explanations in order to verify that the PGA credits were appropriate. (Staff Ex. 9.00, pp. 25-26) Therefore, Staff has no choice but to recommend that the Commission disallow the enovate profits in its entirety.

Q. Is Ms. Decker's adjustment (Additional Direct Testimony of Lindy Decker, City-CUB Ex. 1.0, p. 66) similar to the adjustments you present in ICC Staff Exhibit 9.00, Schedules 9.05 and 9.06?

A. Ms. Decker presents additional reasons to those put forth by Staff (pp. 55-66), but in essence, the adjustments are the same.

174 Noncompliance with the Uniform System of Accounts

175 Q. Did Peoples provide additional documentation since the filing of your
176 additional direct / rebuttal testimony?

177 A. No. Peoples' only response is Company witness Zack's statement that he
178 does not agree that Peoples is out of compliance with the Uniform System
179 of Accounts ("USOA"). (Respondent's Ex. K, Additional Rebuttal
180 Testimony of Thomas E. Zack, p. 16, lines 338-340)

181
182 Q. Did Peoples agree to the USOA compliance report you recommended?
183 (Staff Ex. 9.00, p. 27, lines 651-655)

184 A. No, Company witness Zack states that a compliance report should be part
185 of the audit procedures proposed by Peoples Gas. (Zack, lines 340-342)
186 However, Staff and the Company are not in agreement on the audit
187 requirements to result from this case, therefore it is unacceptable to
188 combine the USOA compliance issue into another contested issue.
189 Therefore, I still recommend that the Commission order the Company to
190 report how it intends to come into compliance with the USOA, regardless
191 of the Commission's findings on any audit requirements.

192

193 Conclusion

194 Q. Have any of your recommendations changed since your additional direct /
195 rebuttal testimony?

A. No, my recommendations are the same, which is that the Commission accept the following adjustments to the Company's PGA reconciliation for FY 2001:

- (1) Refinery Gas Purchases- disallow approximately \$2.2 million in increased costs for refinery gas obtained indirectly from PERC at a price higher than Peoples Gas had paid in previous years (Schedule 9.01);
- (2) PEC Storage Optimization Contract- offset gas costs by \$623,000 for revenues received by PEC as a result of the SOC (Schedule 9.02);
- (3) Enron Storage Optimization Contract- offset gas costs by \$717,455 for revenues received by EMW and Enron as a result of the SOC (Schedule 9.03);
- (4) Trunkline Deal - offset gas costs by approximately \$372,000 for revenues received from the Trunkline Deal since the deal was effectuated with utility assets (Schedule 9.04);
- (5) enovate -PEC Income - offset gas costs by approximately \$9 million as a result of revenue sharing arrangements with enovate (Schedule 9.05); and
- (6) enovate -Enron Income - offset gas costs by approximately \$10.6 million as a result of revenue sharing arrangements with enovate (Schedule 9.06).

In addition, I continue to recommend the following recommendations that I made in my additional direct/ rebuttal testimony:

- I recommend the Commission order the Company to report to the ICC's Chief Clerk and the Manager of the Commission's Accounting Department how it intends to come into compliance with the USOA within 60 days of the order date in this proceeding.
- I share Staff witness Knepler's recommendation that the Company immediately update its operating agreement approved by the Commission in Docket No. 55071. Peoples witness Zack stated that the Company agreed this recommendation has merit. (Respondent's Exhibit K, Additional Rebuttal Testimony of Thomas E. Zack, pp. 13-14 at lines 280-284)
- I recommend the Commission order the Company to allow Staff to use the discovery documents produced in this proceeding in future

234 reconciliation proceedings of the Company and North Shore Gas
235 Company.
236

237 Q. Does this conclude your prepared rebuttal testimony?

238 A. Yes, it does.